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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

UNUM CORPORATION and
UNUM LIFE INSURANCE COMPANY OF AMERICA,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether distributions made to policyholders as part of the demutualization of a mutual life insurance company are deductible "policyholder dividends" under Subchapter L of the Internal Revenue Code, the part of the Code that deals specifically with the taxation of life insurance companies, or instead nondeductible capital distributions under Subchapter C of the Code, the part that deals generally with the taxation of corporations.

The First Circuit below held that such distributions are nondeductible under Subchapter C, resulting in a $77 million tax burden on the petitioner life insurance company. That ruling conflicts with the plain meaning of the statutory definition of the term "policyholder dividend," prior interpretations of that term by other federal circuits and the government, and established principles of statutory construction applied by this Court.

RULE 29.6 STATEMENT

Petitioner UNUM Corporation is the parent company of petitioner UNUM Life Insurance Company of America. UNUM Corporation has two nonwholly owned subsidiaries, Boston Compania Argentina de Seguros S.A. and UNUM Delaware Company. UNUM Life Insurance Company of America has one nonwholly owned subsidiary, SP Administrator, LLC.

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PETITION FOR A WRIT OF CERTIORARI

UNUM Corporation and UNUM Life Insurance Company of America (collectively, "UNUM") respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 130 F.3d 501 and reprinted in the appendix hereto ("App.") at 1a. The opinion of the District Court for the District of Maine is reported at 929 F. Supp. 15 and reprinted at App. 38a.

JURISDICTION

The judgment of the Court of Appeals was entered on December 2, 1997. App. 1a. On February 5, 1998, Jus-

tice Souter entered an order extending the time to petition for certiorari to and including April 16, 1998. *Id.* 62a. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Pertinent provisions of the Internal Revenue Code ("Code"), 26 U.S.C. § 1 *et seq.*, are reprinted at App. 63a-89a. Treasury Regulation § 1.811-2(a) (1961) is reprinted at App. 88a.

INTRODUCTION

To stay competitive in the increasingly diversified American financial marketplace, scores of mutual life insurance companies have converted to stock life insurance companies through a process known as "demutualization." Demutualization has become "increasingly common" in the insurance industry, because it enables life insurance companies to enjoy the advantages of stock companies, including enhanced ability to raise capital by selling stock. App. 3a-4a. A characteristic feature of this transaction is the conversion of policyholders' ownership interests in the mutual company into stock in the new company, or cash in lieu of stock. Petitioners in this case underwent such a demutualization in 1986, resulting in the distribution to policyholders of some $652 million in stock and cash.

The question presented is whether, for federal tax purposes, such policyholder distributions are deductible "policyholder dividends" under the terms of Subchapter L of the Code, the part that deals specifically with the taxation of life insurance companies, or instead nondeductible capital distributions under Subchapter C, the part that deals generally with the taxation of corporations. As the Court of Appeals recognized below, this question has "great financial consequences," not only for insurance companies, but for the "public fisc" at large. App. 2a. The tax bar

has recognized that this action is a "landmark case," likely "to affect the course of many mutuals." S. Preston Ricardo, *The Deductibility of Policyholder Dividends:* UNUM Corp. *v.* United States, 50 Tax Law. 265 (1996) (internal quotation marks omitted). The Nation's largest life insurance company has just announced its intention to demutualize, prompting industry analysts to project that still more demutualizations will follow.

Despite its undeniable importance, the answer to the question presented is subject to conflict and confusion. The Internal Revenue Service ("IRS") initially took the position that distributions made to policyholders during such a demutualization are deductible policyholder dividends, but later flipped its position. *See* App. 12a n.6. While acknowledging that UNUM's position was "plausible," the First Circuit below held that such distributions are nondeductible capital distributions, not policyholder dividends. *Id.* 20a. That ruling conflicts not only with the plain meaning of the statutory definition of the term "policyholder dividend," but with the interpretation of that term by other federal circuits, which have held that Congress intended the term "policyholder dividend" to be given its "expansive," natural meaning. *Republic Nat'l Life Ins. Co.* v. *United States*, 594 F.2d 530, 532 (5th Cir. 1979). To reach its conclusion, the First Circuit disregarded the basic tenets of statutory construction established by this Court's own precedents.

This Court should grant certiorari to resolve the conflict and confusion on the undeniably important question presented.

STATEMENT OF THE CASE

1a. There are two types of life insurance companies. The oldest is the mutual life insurance company, owned by the insurer's policyholders, who share a common equitable ownership interest in the company.[1] Mutual insurers

[1] The first mutual insurer in America, the Philadelphia Contributionship for Insurance of Houses from Loss by Fire, is said to have been created by Benjamin Franklin in 1752.

raise capital by charging "redundant premiums"—*i.e.*, premiums in excess of the amount anticipated to be necessary to pay policy benefits and operating expenses. The "redundant" portion of such premiums is accumulated, retained, and invested as "surplus," and eventually returned to policyholders in whole or part. The other type of life insurance company is the stock life insurance company, organized and owned by stockholders, who may or may not be policyholders. Stock insurers—like other stock companies—raise capital by selling stock. *See Federal Income Taxation of Life Insurance Companies* 4.01 to 4.02 (1997); *Penn Mutual Life Ins. Co.* v. *Lederer*, 252 U.S. 523, 525 (1920).

"Mutual insurance companies have historically lagged behind stock insurers in growth of assets and capital," because stock insurers enjoy greater flexibility in raising capital and, thus, are better positioned to compete in the increasingly diversified financial services marketplace. App. 5a. Stock insurers are better able to raise capital because —rather than having to raise premiums that are already subject to comprehensive state regulation—they can simply sell stock on the equity markets. Stock insurers also are able "more easily [to] diversify their operations by creating upstream holding companies which can own subsidiaries engaged in other businesses," and are able to "create incentives for superior management performance through stock option plans." *Id.* 4a. *See* Wolcott B. Dunham *et al., Demutualization of Life Insurers*, 648 Prac. L. Inst. 9 (1993); Edward X. Clinton, *The Rights of Policyholders in an Insurance Demutualization*, 41 Drake L. Rev. 657, 666-674 (1992).

In light of the financial advantages of stock ownership, many mutual life insurance companies have elected to demutualize and reorganize as stock life insurance companies. A characteristic feature of this demutualization process is the conversion of policyholders' ownership interests in the mutual company—including the ownership interest in any accumulated surplus from the collection of

redundant premiums—into shares in the new stock company, or cash made available to policyholders in lieu of stock. Such demutualizations have become "increasingly common" in the insurance industry, as mutual insurers seek to ensure that they have the "financial strength and flexibility" necessary to compete in the "increasingly competitive and deregulated financial services markets." App. 1a, 5a. *See Deductibility of Policyholder Dividends*, *supra*, at 266-267.[2]

b. The federal tax code accounts for the different manner in which capital flows through mutual life insurance companies and stock companies. Generally speaking, capital contributions to stock companies are *not* treated as income, 26 U.S.C. § 118(a); stock companies do *not* recognize gain or loss on the receipt of money or other property in exchange for stock, *id.* § 1032(a); and, thus, stock companies may *not* deduct such contributions (or earnings thereon) when they are returned to stockholders in

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[2] The Nation's largest life insurance company, Prudential Insurance Company of America, with some $260 billion in assets and $20 billion in net worth, recently announced its intention to demutualize for precisely this reason. *See* Leslie Scism, *Prudential's Plan to Go Public Reflects Industry Trend: More Mutual Life Insurers Need to Seek Outside Capital to Stay Competitive*, Wall St. J., Feb. 18, 1998, at B4. This decision prompted one industry leader to predict that "all major mutual life insurers [will] announce plans for some form of public ownership over the next three years." *Id.* (internal quotation marks omitted). *See also* Leslie Scism, *Prudential to Move to Stock Ownership: Conversion From Mutual Insurer Would be Biggest Ever*, Wall St. J., Feb. 13, 1998, at A3 (Prudential's "move * * * reflects drastic change sweeping the life insurance industry," which is "concerned about keeping pace in the rapidly consolidating financial-services world"). Indeed, "[i]n recent months," several major mutual insurers—in addition to Prudential—have either announced plans to demutualize or taken actions in that direction, including Mutual Insurance of New York and Principle Mutual Life Insurance Co. *See* Leslie Scism, *Wily Investors Seek IPO Score in Their Own Life Insurance*, Wall St. J., Mar. 24, 1998, at C1.

the form of dividends or the like. These rules are spelled out in Subchapter C of the Code, the part that deals generally with the taxation of corporations. Mutual life insurance companies, on the other hand, *are* taxed on the equivalent of such capital contributions—*i.e.*, redundant premiums—when received, and, accordingly, *are* permitted to deduct such amounts when they are returned to policyholders in the form of dividends or the like. *See* 26 U.S.C. §§ 805(a)(3), 808-809. These rules are in Subchapter L of the Code, the part that deals specifically with the taxation of life insurance companies.

Section 803(a)(1) of Subchapter L includes "premiums" in the definition of "life insurance gross income." *Id.* § 803(a)(1). Section 805(a)(3) establishes a deduction for "policyholder dividends," *id.* § 805(a)(3), which Section 808(a), in turn, defines as "any dividend or similar distribution to policyholders in their capacity as such," *id.* § 808(a), and which Section 808(b) specifically provides includes "any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *," *id.* § 808(b)(1). Section 809 establishes a different formula for calculating the policyholder dividends deduction available to mutual life insurance companies, as opposed to stock companies. Subsection 809(f)(4) specifies how a mutual life insurance company should calculate its policyholder dividends deduction for any year in which it demutualizes into a stock insurer, indicating that Congress contemplated that the policyholder dividend deduction would be available in that situation. *See id.* § 809(f)(4).[3]

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[3] Section 809 was the product of a long-standing dispute between stock and mutual insurers over the proper manner of calculating the policyholder dividends deduction for mutual insurers, which was resolved in the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 ("1984 Act"). *See Indianapolis Life Ins. Co. &*

The separate schemes established by the federal tax code for the taxation of capital flowing through corporations in general, in Subchapter C, and insurance companies in particular, in Subchapter L, overlap in the following important respect: in Subchapter C, Congress specifically directed that "[t]he definition [of a taxable dividend under Subchapter C] * * * shall *not* apply to the term 'dividend' as used in subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such." 26 U.S.C. § 316(b) (emphasis added). In other words, Congress not only established an entirely different scheme in Subchapter L for taxing policyholder distributions—in order to take into account the different manner in which capital flows through mutual insurance companies—but it specifically indicated again in Subchapter C that distributions made to insurance policyholders shall be treated differently.

2a. This case arises out of the demutualization of UNUM, a Maine-based company that has been in the life insurance business since 1848. From 1848 to 1986, UNUM operated as a mutual life insurance company called Union Mutual Life Insurance Company ("Union Mutual"). As a mutual insurer, the company had no stock and, in order to raise capital, charged its policyholders redundant premiums, which the company accumulated, retained, and invested as "surplus." From 1959 to 1986, the company's total accumulated surplus grew from approximately $9 million to $652 million, as measured by generally accepted accounting principles. In 1984 Union Mu-

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Subsidiary v. *United States*, 940 F. Supp. 1370, 1372 (S.D. Ind. 1996), *aff'd*, 115 F.3d 430 (7th Cir. 1997); Mark H. Kovey *et al.*, *DRA Introduces New Concepts in Altering Taxation of Life Insurance Companies*, 63 J. Tax'n 48 (1985). While the 1984 Act altered the formula for calculating the amount of the deduction, it left in place the expansive definition of "policyholder dividend" now found in Section 808(a)—*i.e.*, "*any* dividend or similar distribution to policyholders in their capacity as such." 26 U.S.C. § 808(a) (emphasis added).

tual decided to demutualize and reorganize as a stock life insurance company. App. 5a, 8a n.4.

After obtaining the approval of state regulatory authorities as well as its own policyholders, Union Mutual executed a plan of conversion in 1986. The plan terminated the membership interests of eligible policyholders in exchange for either stock in a holding company (UNUM Corporation) or cash in lieu of stock. At the conclusion of this process, UNUM Corporation, the holding company, was owned by former policyholders, various insiders, and the public, and it, in turn, owned UNUM Life Insurance Company. All told, approximately $652 million—the amount that Union Mutual had accumulated in surplus from the collection of redundant premiums and earnings thereon—was distributed in cash and stock to eligible policyholders. The amount paid to policyholders was not fixed in their insurance contracts, but rather was based on a formula drawn by the company for the demutualization based on its experience, and varied on an individual policyholder basis. *Id.* 8a-11a, 39a-43a.

b. In its federal tax return for the 1986 tax year, UNUM initially took a conservative approach and did not claim a deduction for the $652 million in policyholder distributions made during the demutualization.[4] Pursuant to an agreement it had entered into with the IRS, however, UNUM later amended its 1986 return and—based on further analysis of the federal tax consequences of demutualization—claimed that the stock and cash distributions were

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[4] Prior to the demutualization, Union Mutual asked for a private letter ruling from the IRS, addressing certain tax issues related to the demutualization. The IRS, in turn, asked Union Mutual for its view on whether the resulting cash distributions would be deductible "policyholder dividends." Union Mutual answered in the affirmative, but the IRS took the contrary position. *See* App. 10a-12a; Priv. Ltr. Rul. 87-11-121 (Dec. 16, 1986). By regulation, however, this ruling was not binding on either UNUM or the government. *See* Treas. Reg. § 601.201(*l*).

deductible "policyholder dividends" under Sections 805 and 808 of Subchapter L of the Code.[5] Taking these deductions into account, UNUM's amended return for 1986 sought a refund of $77 million. The IRS refused to recognize the claimed deductions on the ground that policyholder distributions made as part of a demutualization are capital distributions governed by the general corporate tax provisions in Subchapter C—not Subchapter L—and, accordingly, denied UNUM's refund request. App. 12a-13a.

3a. In 1993 UNUM brought this action in the United States District Court for the District of Maine, seeking a ruling that it is entitled to a policyholder dividends deduction and the resulting refund. The District Court initially denied the government's motion for summary judgment, but then ruled for the government on a stipulated record. *See id.* 38a. The court framed the "dispositive issue" as whether distributions made to policyholders during a demutualization "fall within the definition of 'policyholder dividend' contained in I.R.C. § 808 and are, therefore, deductible under I.R.C. § 805(a)(5)." App. 45a-46a. In answering that question, the court rejected UNUM's plain meaning construction of Section 808 on the ground that the definition of the term "policyholder dividend" must be construed "strictly," *id.* 47a—*i.e.*, not literally. Then, applying its "strict[]" construction, the court held that the distributions at issue are not "policyholder dividends," because, while "the distribution amounts are not fixed in the contract," they are not sufficiently "dividend-like" to qualify for the deduction. *Id.* 59a (internal quotation marks omitted).

b. UNUM filed a timely appeal and the First Circuit affirmed. The Court of Appeals acknowledged that

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[5] It is undisputed that, in claiming this deduction, UNUM fully complied with Section 809 of the Code, including the special rule in Section 809(f)(4) governing calculation of the deduction when the insurer demutualizes. *See* 26 U.S.C. § 809(f)(4).

UNUM's plain meaning construction of Section 808 was both "colorable" and "plausible," *id.* 13a, 20a, but nevertheless felt obliged to reject it under the "rule of *Colonial American*," which—according to the Court of Appeals—provides that the "general corporate tax provisions of Subchapter C apply to insurance companies unless Subchapter L makes a specific provision to the contrary." *Id.* 16a. The First Circuit derived this "rule" from *Colonial American Life Insurance Co.* v. *Commissioner*, 491 U.S. 244 (1989), a case that—up to that point—had received scant attention from the parties and had been ignored completely by the District Court, and which does not even mention Subchapter C (or any of its provisions). Applying this "rule," the Court of Appeals held that the specific provision set forth in Subchapter L authorizing life insurance companies to deduct "policyholder dividends" from gross income does not cover distributions made during a demutualization, because "nothing in § 808 * * * specifically overrides th[e] general rules" found in Subchapter C. App. 25a.

In rejecting UNUM's plain meaning interpretation, the First Circuit acknowledged that other federal circuits had interpreted the term "policyholder dividend" "expansive-[ly]"—giving effect to the plain meaning of the broadly worded statutory definition—in order to account for Congress' " 'inten[t] to include *more* than just classic dividends' within policyholder dividends." *Id.* 27a n.13 (quoting *Republic Nat'l Life Ins. Co.*, 594 F.2d at 532) (emphasis added); *accord id.* 19a. But the First Circuit dismissed that approach, and held instead that "[a]ny distribution by an insurer to its policyholders must * * * bear the essential characteristics of a [corporate] dividend * * * in order to qualify as a 'policyholder dividend.' " App. 26a. The Court of Appeals also declined to give any weight to the "broad scope" of the Treasury Department's interpretation of the term "policyholder dividend." *See id.* 19a.

c. On February 5, 1998, Justice Souter entered an order extending the time to petition for certiorari to and including April 16, 1998. *Id.* 62a.

REASONS FOR GRANTING THE WRIT

I. THE QUESTION PRESENTED IS OF UNDENIABLE IMPORTANCE BOTH TO MUTUAL LIFE INSURERS AND TO THE PUBLIC FISC.

As the Court of Appeals acknowledged below, the question whether distributions made to policyholders as part of a demutualization are deductible "policyholder dividends" has "great financial consequences" not only for mutual insurers, but for the "public fisc." *Id.* 2a. The size of the claimed policyholder dividends deduction in this case alone is $652 million, which translates into a $77 million tax burden if the deduction is denied.[6] Because demutualizations have become "increasingly common" in the insurance industry—and, as recent developments indicate, are likely to become even more prevalent, *see* note 2, *supra*—the availability of the policyholder dividends deduction in these circumstances could easily have a several billion dollar impact on mutual insurers (and their policyholders) through the close of this century alone.[7] It is not surprising to find, then, that this action

[6] Seventy-seven million dollars is the amount of the tax refund UNUM was owed as of 1988, assuming distributions made to policyholders as part of a demutualization are deductible "policyholder dividends." But as of 1988, UNUM had not claimed as deductions all of the distributions made during the demutualization; it carried forward more than $480 million in such deductions, which—if the plain import of the statutory scheme is given effect—could result in additional tax refunds in future years. In other words, much more than $77 million is actually at stake in this case alone.

[7] This is not to say that giving effect to the plain meaning of the policyholder dividends deduction would result in a several billion dollar loss of tax revenue to the government. Demutualizations by their nature generate huge amounts of tax revenues. Policyholder dividends, unlike amounts paid in redemption of stock, are taxable to

already has been recognized as a " 'landmark case,' " " 'expected to affect the course of many mutuals.' " *Deductibility of Policyholder Dividends, supra,* at 265 (quoting *Summaries of Today's Important Tax Items,* Tax Notes Today (Aug. 21, 1995)).

The undeniable importance of the question presented both to mutual insurers and to the government, as well as to the administration of the federal tax laws, alone warrants granting the writ. *See, e.g., United States* v. *Goodyear Tire & Rubber Co.,* 493 U.S. 132, 138 (1989) (certiorari granted because "Court of Appeals' decision has important consequences for the calculation of the indirect tax credit" available to certain companies); *Thor Power Tool Co.* v. *Commissioner,* 439 U.S. 522, 525 (1979) ("certiorari [granted] to consider these important and recurring income tax accounting issues"); *Commissioner* v. *Lincoln Sav. & Loan Ass'n,* 403 U.S. 345, 346-347 (1971) ("Because of the importance of [federal tax] issue for the savings and loan industry and for the Government, we granted certiorari."); *Commissioner* v. *Estate of Noel,* 380 U.S. 678, 680 (1965) ("Because of the importance of an authoritative answer to these questions in the administration of the [federal] tax laws, we granted certiorari to decide them"); *Meyer* v. *United States,* 325 U.S. 233, 234 (1963) ("We granted certiorari because of the importance of the question in the administration of the income tax laws."); *accord United States* v. *Stapf,* 375 U.S. 118, 120 (1963); *United States* v. *Cannelton Sewer Pipe Co.,* 364 U.S. 76, 78 (1960); *United States* v. *Korpan,* 354 U.S. 271, 273 (1957).

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the policyholder as ordinary income to the extent such distributions exceed the policyholder's investment in the insurance contract. *See* 26 U.S.C. § 72(e). In addition, as the value of the new stock company increases following the demutualization, sales and resales of the converted company's stock generate ongoing revenue that would not have been realized if the company had remained a mutual insurer.

The question presented, however, is not only one of great consequence; it is one on which conflict and confusion exist.

II. THE FIRST CIRCUIT DECISION CONFLICTS WITH THE PLAIN MEANING OF THE STATUTE, AND WITH THE PLAIN MEANING INTERPRETATION OF THE TERM "POLICYHOLDER DIVIDEND" BY OTHER FEDERAL CIRCUITS.

1. Section 808 of Subchapter L of the Internal Revenue Code defines the term "policyholder dividend" in plain and unambiguous terms. A "policyholder dividend" is "any dividend or similar distribution to policyholders in their capacity as such." 26 U.S.C. § 808(a). Section 808(b) then specifies that "policyholder dividend * * * includes * * * any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *." *Id.* § 808(b)(1). This definition is straightforward and, when applied to the facts that the distributions in this case (1) were made to UNUM's policyholders as such, (2) were not fixed by contract, and (3) were calculated based on the past experience of UNUM in collecting and investing premiums and meeting the costs of insurance and operations, *see* App. 6a-10a; C.A. App. 248, 252, 256, 335, 339, 377-386, 417, 514, 612, 591-593, results in the inexorable conclusion that the distributions are policyholder dividends within the meaning of Section 808 and, thus, deductible pursuant to Section 805(a)(3).

2. This conclusion squares with the plain meaning interpretation of the term "policyholder dividend" adopted by other federal circuits. For example, in *Republic National Life Insurance Co.* v. *United States*, 594 F.2d at 532 (emphasis added), the Fifth Circuit stated that Subchapter L's definition of "policyholder dividend" is "expansive," and was plainly "intended to include *more* than

just classic dividends." *See also id.* at 536 (congressional "debates reflect an understanding that 'dividend' as used in the insurance industry is a term of art which means almost *any* payment not derived solely from premium income") (district court decision adopted by Fifth Circuit in relevant part) (emphasis added). *See also Prairie States Life Ins. Co.* v. *United States*, 828 F.2d 1222, 1226 (8th Cir. 1987) (Subchapter L's "unambiguous and straightforward" statutory scheme "essentially treats all distributions to policyholders" as a return of redundant premiums, or policyholder dividends); *Modern Am. Life Ins. Co.* v. *Commissioner*, 92 T.C. 1230, 1243 (1989) ("Congress was aware that 'dividend' as used in the insurance industry is a term of art which means almost *any* payment not derived from premium income.") (internal quotation marks omitted; emphasis added).[8]

These cases involved the taxation scheme established by the Life Insurance Company Income Tax Act of 1959 ("1959 Act"), Pub. L. No. 86-69, 73 Stat. 112, which is codified in Subchapter L of the Code. Under the 1959 Act, amounts refunded to policyholders were divided into two categories: "return premiums," which were deductible in whole, and "policyholder dividends," which were de-

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[8] The First Circuit decision below is also at odds with *Ruocco* v. *Bateman, Eichler, Hill, Richards, Inc.*, 903 F.2d 1232 (9th Cir.), *cert. denied*, 498 U.S. 899 (1990). *Ruocco* arose out of the same demutualization underlying this case. The plaintiffs were employees who participated in a long-term disability plan offered by the defendant employer (BEHR). The plan's long-term disability carrier was UNUM. When UNUM demutualized, BEHR received some $500,000 in policyholder distributions. The employees claimed that BEHR had violated ERISA and various state law duties by failing to redistribute the distributions to plan participants. *Id.* at 1234-35. Among other things, BEHR argued that it was entitled to retain the surplus under a provision of California insurance law that permits an employer of insureds to retain policyholder "dividend[s]." *Id.* at 1236 (quoting statute). In pertinent part, the Ninth Circuit held that "the distribution of the surplus constitutes a *dividend* under the [statute]." *Id.* at 1237 (emphasis added).

ductible in part. *See American Nat'l Ins. Co.* v. *United States*, 690 F.2d 878, 882 (Ct. Cl. 1982). The touchstone for distinguishing between these two categories was whether the amount was fixed by contract. Thus, the 1959 Act defined "policyholder dividends" as "dividends and similar distributions to policyholders in their capacity as such," 26 U.S.C. § 811(a) (1959), then provided that "amounts returned where the amount is *not* fixed in the contract but depends on the experience of the company or the discretion of management shall not be included in return premiums," *id.* § 809(c)(1) (emphasis added). In other words, under the 1959 Act, amounts that were not fixed in the contract but instead depended on the experience of the company or the discretion of management were policyholder dividends. *See Prairie States Life Ins. Co.*, 828 F.2d at 1225; S. Rep. No. 86-291, at 813 (1959).

In 1961 the Treasury Department issued a formal regulation underscoring the breadth of the term "policyholder dividend" under this scheme. It provided in pertinent part:

> Section 811(a) defines the term "dividends to policyholders" * * * to mean dividends and similar distributions to policyholders in their capacity as such. The term includes amounts returned to policyholders where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management. In general, *any* payment not fixed in the contract * * * shall be treated as a dividend to policyholders. Similarly, *any* amount refunded or allowed as a rate credit * * * shall be treated as a dividend to policyholders if such amount depends on the experience of the company. [Treas. Reg. § 1.811-2(a) (1961) (emphasis added).]

3. In litigation arising under the 1959 Act the government took the position that the term "policyholder dividend" should be broadly construed, consistent with the plain meaning of the broadly worded statute and 1961 Treasury Regulation. *See, e.g., Republic Nat'l Life Ins.*

Co., 594 F.2d at 532. Under the scheme established by the 1959 Act, that position was generally favorable to the government, since policyholder dividends were only deductible in part, whereas the other alternative—return premiums—were deductible in their entirety. As noted, courts of appeals adopted this plain—and "expansive"—interpretation of the term. *Id.* *See supra* at 13-14.

In 1984 Congress passed new legislation that altered the formula established by the 1959 Act for calculating the amount of the policyholder dividends deduction, *see* 26 U.S.C. § 809, but, at the same time, cemented the expansive definition of the term "policyholder dividends." *See* Deficit Reduction Act of 1984 ("1984 Act"), Pub. L. No. 98-369, 98 Stat. 494. Congress underscored the breadth of the term "policyholder dividend" in two important respects: first, it added the word "any" prior to "dividend or similar distribution" in Section 808(a), 26 U.S.C. § 808(a); and second, it codified the interpretation in the 1961 Treasury Regulation, adding the proviso in Section 808(b) that the term " 'policyholder dividend' * * * includes * * * any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *." *Id.* § 808(b)(1).

These amendments are telling. As Justice Frankfurter has explained, when a concept "is obviously transplanted from another legal source, * * * it brings the old soil with it." Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 537 (1947). Here, the government had adopted the 1961 Treasury Regulation to ensure that the term "policyholder dividend" would be construed broadly, in accordance with its broad terms; the courts accepted the government's expansive reading of that term; and, in the 1984 Act, Congress explicitly codified that understanding. The language Congress chose—"*any* dividend or similar distribution" and "*any* amount * * * not fixed in the contract," 26 U.S.C. § 808(a), (b)—

was aptly suited to its purpose. *See Salinas* v. *United States*, 118 S. Ct. 469, 473 (1997) ("The word 'any' * * * undercuts the attempt to impose [a] narrowing construction."); *Bennett* v. *Spear*, 117 S. Ct. 1154, 1162 (1997) (phrase "any person," though of "remarkable breadth," should be taken at "face value").

But while the 1984 Congress cemented the broad definition of what constitutes a "policyholder dividend" within the meaning of Subchapter L, it changed the deductibility rules so that the expansive definition was now more favorable to the *taxpayer*.[9] This policy change—which Congress adopted in order to "level the playing field" between stock and mutual insurers, Kovey *et al.*, *supra*, at 48—apparently caused the government to reconsider its interpretation. Not long after the 1984 Act became law, the government abandoned its prior interpretation of the term "policyholder dividend" and took the position that the same language it had said should receive an expansive interpretation should now be narrowly construed.

This abrupt about-face is vividly illustrated by the IRS' flip-flop on the precise question presented by this case. In 1983 the IRS took the position—advanced by UNUM in this case—that cash distributions made to policyholders during the demutualization of a mutual casualty insurer through a merger with a stock insurer were "policyholder dividends." IRS Tech. Adv. Mem. 8409003 (Nov. 4, 1983) ("The distribution to Mutual's policyholders upon

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[9] Generally speaking, whereas the 1959 Act imposed a ceiling on the amount of policyholder dividends an insurer was permitted to deduct, the 1984 Act permits unlimited deductions of policyholder dividends, subject to the condition that the deduction for such dividends declared by any mutual insurer in any year would be reduced in accordance with a formula based on the relative industry-wide rates of return of mutual and stock life insurers as computed annually by the Treasury Department. *See* C.A. App. 665 (Dep't of the Treasury, *Final Report to the Congress on Life Insurance Company Taxation* 25 n.8) (explaining how Section 809 works); H.R. Rep. No. 98-432, at 1422-26 (1984) (same).

merger into taxpayer was a policyholder dividend."). In 1989, however, the IRS summarily "revoked" that position. IRS Tech. Adv. Mem. 9010003 (Nov. 13, 1989). *See* App. 12a n.6 (acknowledging change in IRS position on "the tax treatment of distributions from surplus made during a demutualization"); *Federal Income Taxation of Life Insurance Companies*, *supra*, § 8.02[3], at 8-67 n.156.2 (same).[10]

The government's inconsistent and transparently result-oriented position on the reach of the term "policyholder dividend" exacerbates the uncertainty that shrouds the question presented. The fact that the government has now succeeded in convincing different courts of appeals to adopt its conflicting positions makes this uncertainty especially problematic, and calls for this Court's review. *See* S. Ct. Rule 10(a).

4. The First Circuit in this case acknowledged that other federal circuits have held "that 'policyholder dividends' have an 'expansive definition' and 'include *more* than just classic dividends,' " App. 19a (quoting *Republic Nat'l Life Ins. Co.*, 594 F.2d at 532) (emphasis added), and observed that UNUM's plain meaning interpretation was both "plausible" and "colorable." App. 13a, 20a. But, at the government's urging, the court rejected that interpretation and refused to conclude that the distributions at issue fit within the statutory definition of the term "policyholder dividend." Thus, according to the First Circuit, the "mere fact that 'policyholder dividends' are not 'fixed' by the terms of an insurance contract does not mean that they include any distribution that a mutual insurer makes to its policyholders in any capacity." *Id.* 35a-36a. Instead, the Court of Appeals held, a more searching

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[10] Technical advice memoranda are not binding on the IRS, but the IRS' about-face on the question presented in the 1983 and 1989 memoranda cited above is nevertheless illustrative of the inconsistent positions that the government has taken on the important question presented by this case.

inquiry was required to determine whether the distribution at issue is "fundamentally" like a " 'dividend or similar distribution,' " when viewed from the perspective of a classic corporate dividend taxable pursuant to Subchapter C. *Id.* 28a, 36a.

That approach conflicts with the plain meaning of the broadly worded definition of the term "policyholder dividends," and with the plain meaning interpretation of that term by other federal circuits. Indeed, whereas other circuits have held that "policyholder dividends" was "intended to include *more* than just classic dividends," *Republic Nat'l Life Ins. Co.*, 594 F.2d at 532 (emphasis added), the First Circuit below concluded that the term is "subject to the constraints which *limit* the classic definition of dividends." App. 18a (emphasis added). *See id.* 26a (Section 808 "requires all 'policyholder dividends' to possess the essential characteristics of a dividend"). As a result, mutual insurers doing business in the First Circuit may no longer obtain the full benefit of the policyholder dividends deduction that Congress established in order to ensure the fair tax treatment of capital contributions flowing through mutual and stock insurers.

That conflict—over the meaning of an important provision of the federal tax code—should be resolved by this Court. *See* S. Ct. Rule 10(a). As explained next, however, it is not the only conflict presented by this case, because the *manner* in which the First Circuit reached that interpretation directly conflicts with this Court's own precedents and, more particularly, the settled norms of statutory construction this Court has applied in construing the federal tax code and other statutes.

III. THE FIRST CIRCUIT DECISION CONFLICTS WITH THIS COURT'S OWN PRECEDENTS AND WITH SETTLED NORMS OF STATUTORY CONSTRUCTION.

1. The first rule of statutory construction is of course that the statute's plain meaning should be given effect. *See Estate of Cowart* v. *Nicklos Drilling Co.*, 505 U.S.

469, 475 (1992) (when "a statute speaks with clarity to an issue judicial inquiry into the statute's meaning, in all but the most extraordinary circumstance, is finished"); *United States* v. *Ron Pair Enters.*, 489 U.S. 235, 242 (1989) ("The plain meaning of legislation should be conclusive, except in the rare cases in which the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.") (quotation and brackets omitted); *Commissioner* v. *Engle*, 464 U.S. 206, 214 (1984) (starting point is "the language of the statute itself"); *United States* v. *Wiltberger*, 18 U.S. (5 Wheat.) 76, 95-96 (1820) (Marshall, C.J.) ("Where there is no ambiguity in the words, there is no room for construction."). In this case, application of that rule leads to the conclusion that the distributions at issue are "policyholder dividends" within the meaning of Section 808; the sheer breadth of the statutory definition permits no other conclusion. *See supra* at 13.

The First Circuit below, like the District Court before it, immediately sought to circumvent that plain meaning by invoking the canon that "[d]eductions must * * * be 'strictly construed.' " App. 17a (quoting *INDOPCO, Inc.* v. *Commissioner*, 503 U.S. 79, 84 (1992)). *See also* App. 47a (District Court). That canon, however, is only a "default rule of statutory interpretation." *Commissioner* v. *Schleier*, 515 U.S. 323, 327 (1995) (internal quotation marks omitted). It does not trump the rule that the statute's plain meaning controls when, as here, the statute is unambiguous. *See Estate of Swan* v. *Commissioner*, 247 F.2d 144, 148 (2d Cir. 1957) ("although as a general rule exemptions and deductions are to be strictly construed, that general rule of construction must bow to clear statutory language and policy"); *see also Connecticut Nat'l Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992) ("[C]anons of construction are no more than rules of thumb that help courts determine the meaning of legislation, and in interpreting a statute a court should always turn first to one, cardinal canon before all others. * * *

[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there.").

Thus, even when "strictly construed," a deduction is allowed when there "is clear provision therefor." *INDOPCO, Inc.*, 503 U.S. at 84 (internal quotation marks omitted). Section 808 is such a "clear provision" in the case of policyholder dividends; under the first rule of statutory construction, then, the First Circuit was required to give effect to that provision.

2. To avoid this conclusion, the First Circuit also trumpeted what it referred to as "the rule of *Colonial American*," under which, the Court of Appeals held, the "general corporate tax provisions of Subchapter C apply to insurance companies unless Subchapter L makes a specific provision to the contrary." App. 16a. The court drew this "rule" from this Court's decision in *Colonial American Life Insurance Co.* v. *Commissioner, supra,* a case which had received little more than passing reference from the parties and was tellingly ignored by the District Court. *Colonial American* not only does not purport to erect the blanket rule of statutory construction articulated by the First Circuit below, but is plainly distinguishable from this case, which of course accounts for the scant attention it received up to the point of the First Circuit decision. Indeed, contrary to the panel's apparent misunderstanding, *Colonial American* does not even mention Subchapter C (or any of its provisions), let alone purport to "address[] the relationship between Subchapter C and Subchapter L." App. 16a (First Circuit decision).

The question in *Colonial American* was whether ceding commissions paid by a reinsurance company to a direct insurer under an indemnity reinsurance contract may be taken as current deductions or, instead, must be amortized over the life of the reinsurance agreements. The taxpayer argued that the ceding commissions were analogous to agents' commissions and expenses, which are deductible

under Section 809 of Subchapter L. The government argued that the commissions were analogous to capital expenditures required to be amortized under Section 263 of the Code (which is not found in Subchapter C). Because it agreed with the government's analogy, the Court held that the ceding commissions must be amortized "absent some specific statutory provision indicating" that they were subject to different tax treatment. 491 U.S. at 253. The taxpayer argued that such a provision existed in Subchapter L, but the Court disagreed. *See id.* at 260.

This case, unlike *Colonial American*, does not require the Court to draw far-reaching analogies in order to determine whether the amounts at issue are taxable under Subchapter L or another section of the Code. Rather, it simply requires the Court to read the statute and determine whether the amounts at issue fit within the statutory definition of "policyholder dividend." This is because, in this case, unlike *Colonial American*, there *is* a "specific statutory provision" directly on point—Section 808 of Subchapter L. *Colonial American* provides no basis for the Court to disregard that specific provision under the guise of looking to the general *corporate* provisions in Subchapter C, which, as noted, were not even implicated by *Colonial American*. *See Deductibility of Policyholder Dividends*, *supra*, at 276 ("Section 808 of Subchapter L * * * expressly provides that distributions of property made by an insurance company to its policyholders as such shall be treated under its provisions, *removing analysis of the distribution from Subchapter C.*") (emphasis added).

More fundamentally, the First Circuit's reading of *Colonial American* turns on its head the settled maxim of statutory construction that the specific overrides the general. *See Edmond* v. *United States*, 117 S. Ct. 1573, 1578 (1997) ("Ordinarily, where a specific provision conflicts with a general one, the specific governs."); *Morales* v. *Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992) ("it is a commonplace of statutory construction that the

specific governs the general"); *HCSC-Laundry* v. *United States*, 450 U.S. 1, 6 (1981) ("it is a basic principle of statutory construction that a specific statute * * * controls over a general provision"); *Jett* v. *Dallas Independent School Dist.*, 491 U.S. 701, 738-739 (1989) (Scalia, J., concurring in part and concurring in judgment) ("rudimentary principles of construction [hold] that the specific governs the general").

As a leading treatise puts it, "Subchapter L contains intricate and specialized provisions for the taxation of life insurance companies." Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 1.06 (6th ed. 1994). *See also* Robert C. Clark, *The Federal Income Taxation of Financial Intermediaries*, 84 Yale L.J. 1603, 1637 (1974) (discussing the Code's "special tax provisions applicable to life insurance companies"). Subchapter C, by contrast, governs the taxation of corporations in general. *See Helvering* v. *Oregon Mut. Life Ins. Co.*, 311 U.S. 267, 268-269 (1940) (since 1921 life insurance companies have been "wholly exempted * * * from the general scheme of corporation taxation" established by the Internal Revenue Code, and have been subject to "special systems [of taxation] applicable to them alone"). Both subchapters define and establish rules governing the taxation of dividends or similar distributions. *Compare* 26 U.S.C. § 316 (defining corporate dividends in general) *with* § 808 (defining policyholder dividends in particular).

Under the time-honored rule that the specific overrides the general, the specific policyholder dividend provision in Subchapter L trumps the general corporate dividend provision in Subchapter C. The First Circuit below, however, turned that rule on its head, and decided the important question presented based on the principle that the "general corporate tax provisions of Subchapter C apply to insurance companies unless Subchapter L makes a specific provision to the contrary." App. 16a. That skewed

perspective placed an inappropriate burden on UNUM in attempting to establish that it is entitled to the claimed deduction and, more important, led the Court of Appeals to misconstrue the clear intent of Congress in Section 808 to treat the type of distributions at issue in this case as deductible policyholder dividends.[11]

Congress, in any event, eliminated any room for argument on this important point. It included in the Code a specific statutory provision expressly providing that the general rules in Subchapter C do *not* apply in this instance. Section 316(b) of the Code specifies that the definition of a dividend in Subchapter C "shall *not* apply to the term 'dividend' as used in subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such." 26 U.S.C. § 316(b) (emphasis added). This specific provision is found in Subchapter C rather than L, but surely that is not significant in applying the so-called "rule" of *Colonial American*. Invoking general corporate dividend principles to construe Subchapter L's specific "policyholder dividend" provision is thus directly contrary not only to the rule that the specific trumps the general, but also to Congress' express direction in Section 316(b).

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[11] In another, perhaps even more inexplicable misapplication of the canon that the specific overrides the general, the First Circuit refused to construe the general definition of "policyholder dividends" in Section 808(a) in light of the specific direction in Section 808(b) that "policyholder dividend * * * *includes* * * * any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *." 26 U.S.C. § 808(b)(1) (emphasis added). *See* App. 25a-26a. Thus, under the First Circuit construction, even if a distribution is a "policyholder dividend" under a plain reading of Section 808(b), it will not be a "policyholder dividend" within the meaning of Section 808(a) unless it meets the First Circuit *a priori* requirement—not found in the text or plain meaning of the statute—that the distribution "possess the essential characteristics of a dividend" taxable under Subchapter C. *Id.* 26a.

3. The First Circuit interpretation also conflicts with this Court's precedents emphasizing that "the meaning of a word * * * must be drawn from the *context* in which it is used." *Deal* v. *United States*, 508 U.S. 129, 132 (1993) (emphasis added). *See King* v. *St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991) ("[T]he meaning of statutory language, plain or not, depends on context."); *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803, 809 (1989) ("It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.").

In construing the term "policyholder dividend," the Court of Appeals, like the District Court before it, looked to general corporate law principles and ultimately held that, to qualify as a "policyholder dividend," a "distribution * * * must * * * bear the essential characteristics of a [corporate] dividend." App. 26a. Looking to the characteristics of general corporate dividends taxable under Subchapter C of the Code to define the term "policyholder dividend" in Subchapter L, however, is a bit like looking to Roger Tory Peterson's *Field Guide to Eastern Birds* to define the term "eagle" in the game of golf. When the term "policyholder dividend" is viewed from the *context* in which Congress drafted it, it takes on an entirely different meaning from the one the First Circuit assigned to it.

Indeed, that much is clear from the separate dictionary definition of the term "dividend"—as that term is used in the *insurance* context—which existed when Congress first adopted the term "policyholder dividend" in the 1959 Act. *See Webster's New International Dictionary of the English Language* 195 (2d ed. unabridged 1957) ("A share of surplus allocated to a policyholder in a participating insurance policy, which generally represents a return of a portion of the premium not needed to meet losses and expenses, and a distribution of earnings from investment."). The principal drafter of the statutory definition

of the term "policyholder dividend" now codified in Section 808(a) made that clear, too, when he explained at the time of the passage of the 1959 Act that "the word 'dividend' in life insurance companies has a different connotation than we would use in the investment field." 105 Cong. Rec. 2571 (1959) (statement of Sen. Curtis). *See also Republic Nat'l Life Ins. Co.*, 594 F.2d at 536 (congressional "debates reflect an understanding that 'dividend' as used in the insurance industry is a term of art which means almost any payment not derived solely from premium income") (quoting district court decision).

4. Finally, the First Circuit interpretation conflicts with the canon—which this Court has emphasized in construing the Internal Revenue Code—that a court should remain "faithful to the history of the statutory provision as well as the basic tax-related purpose that the history reveals." *O'Gilvie* v. *United States*, 117 S. Ct. 452, 455 (1996). *See also Commissioner* v. *Engle*, 464 U.S. at 217 (court should examine Code provision in the context of its history and purpose in order to "find that interpretation which can most fairly be said to be imbedded in the statute, in the sense of being most harmonious with its scheme and with the general purposes that Congress manifested.") (internal quotation marks omitted).

The 1959 Act was enacted in large measure because of Congress' recognition of the different manner in which capital flows through mutual companies as opposed to stock companies, and its concern that mutual insurance companies were being unfairly treated by a tax code that failed to take that difference adequately into account. As the Fifth Circuit put it:

> Congress recognized that the deduction for dividends to policyholders would benefit the mutual companies who wrote participating policies. In fact, one of Congress's principal areas of concern when it enacted the 1959 Act was the relative tax burdens of the mutual and stock companies. Congress further recognized

> that the tax treatment of dividends would in large measure determine the tax distribution between mutual and stock companies. [*Republic Nat'l Life Ins. Co.*, 594 F.2d at 533 (citing H.R. Rep. No. 86-34, at 5 (1959)).]

In 1984 Congress amended Subchapter L in an effort to further "level the playing field" between stock and mutual insurers. Kovey *et al.*, *supra*, at 48. In doing so, Congress expressly confirmed the expansive reach of the term "policyholder dividend," adding "any" to the general definition in Section 808(a) and adding the more specific proviso in Section 808(b) that "policyholder dividend * * * includes * * * any amount paid or credited * * * where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management * * *." 26 U.S.C. § 808(b)(1). It also eliminated the ceiling on the deductibility of policyholder dividends, *see id.* § 808; note 3, *supra*, and adopted a "special rule" for determining the amount of the policyholder dividend deduction in any year in which a mutual insurer undergoes a demutualization, *see* 26 U.S.C. § 809(f)(4)—indicating that Congress was well aware of the natural application of the policyholder dividend deduction to distributions made as part of a demutualization.

The First Circuit ruling flies in the face of the history and purpose of the policyholder dividends deduction, disrupting the careful balance Congress sought to achieve between the tax treatment of mutual insurers and stock companies in enacting and then amending the pertinent provisions of Subchapter L. Indeed, "[i]t is of the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder." *Penn Mut. Life Ins. Co.*, 252 U.S. at 525. *See Lincoln Nat'l Life Ins. Co.* v. *United States*, 582 F.2d 579, 593-594 n.9 (Ct. Cl. 1978). The purpose of the policyholder dividends deduction is to ensure that mutual insurers are permitted to deduct "*any*" such "dividends or

similar distributions" when made. 26 U.S.C. § 808(a) (emphasis added). Nothing in Subchapter L, or its history or purpose, suggests that the policyholder dividends deduction is unavailable simply because the distributions are made as part of a demutualization.[12] Section 809(f)(4) alone is evidence to the contrary. But there is no need to reach that level of specificity. A plain reading of the statute compels the conclusion that the policyholder dividends deduction is available in these circumstances.

Especially in view of the undeniable importance of the question presented, the clear conflict between the First Circuit decision and this Court's own precedents establishing the rules governing the construction of federal statutes provides an independent reason for granting the writ. *See* S. Ct. Rule 10(c).

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[12] The fact that the policyholder dividends in this case were paid upon dissolution of the mutual insurer should not alter this conclusion. *See Mutual Fire Ins. Co.* v. *United States*, 142 F.2d 344, 349 (3d Cir.) ("In a true mutual insurance company the members * * * are entitled to receive its net assets upon dissolution."), *cert. denied*, 323 U.S. 729 (1944); *Order of Ry. Employees* v. *Commissioner*, 2 T.C. 607, 615 (1943) (mutual insureds, "and they alone, are entitled to dividends, whether resulting from current operations or paid upon dissolution"), *appeal dismissed*, 143 F.2d 597 (9th Cir. 1944).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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